No. 294

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1944

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CITY BANK FARMERS TRUST COMPANY, formerly known as The Farmers Loan and Trust Company, as Administrator of the goods, chattels and credits of HELEN HALL VAIL, deceased,

*Petitioner,*

*against*

GEORGE T. McGOWAN, Collector of Internal Revenue for the Twenty-Eighth Collection District, New York.

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

## REPLY BRIEF FOR PETITIONER

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## REPLY BRIEF FOR PETITIONER

In the interest of accuracy, we desire to point out that on several instances respondent refers to the allowances made to the decedent's daughter and others either as having been made out of the incompetent's *estate*, or as *distributions of her property* (Res. Br., pp. 2, 11, 12, 14, 17, 29, 35). We would point out that in no instance was the *principal* of the incompetent's estate to be expended under either of the allowance orders; they specifically provided that all of the allowances were to be paid out of *income*.

## ARGUMENT

### 1. The Respondent's contention that the New York courts have the power to make substitutes for testamentary dispositions.

Respondent concedes, and the decisions so hold, that the New York Supreme Court has no jurisdiction to make a testamentary disposition of an incompetent's property, but respondent asserts that such court is fully authorized to make a substitute for such disposition, upon the finding that the incompetent, if competent, himself would have done so. Thus respondent must concede that even though it were proved that an incompetent shortly before the loss of his sanity had prepared and finally approved a last will and testament and in the last moments of his sanity was about to execute it, a state court nonetheless would have no jurisdiction to validate the will on the incompetent's behalf.

As respondent asserts (Res. Br., p. 31) the effect of the Federal Estate Tax Law is to cover all *inter vivos* gifts that are made "with the same motives as generally lead to testamentary dispositions." If the New York courts have not the power to make testamentary dispositions, they certainly have not the power to make *any* transfer prompted by the same motives as are testamentary dispositions.

And yet respondent urges that upon the facts of a stated hypothetical case (Res. Br., pp. 19-20) the state court would have the power to put into effect a substitute for a testamentary disposition which the court found the incompetent might formulate if sane. Since the New York courts admittedly have no power to make a direct testamentary disposition, it necessarily follows that they do not have the power to make a substitute therefor. The machinery erected by the New York law for the conservation of in-

competents' estates clearly precludes the making of substitute, as well as actual, dispositions of this character.

If respondent's hypothetical case, above referred to, which involves a gift clearly in contemplation of death within the meaning of the Federal statute were before the New York Supreme Court we feel confident that that court would have made short shrift of the application. The court's power is by no means as broad as the incompetent's probable wishes. The general principles of equity will not be applied to frustrate the purpose of the laws or to thwart public policy. Equity will not permit that to be done by indirection which, because of public policy, cannot be done directly. Corpus Juris Secundum, Vol. 30, p. 458; *Knight Products, Inc.* v. *Donnen-Fuel Co., Inc.*, .. Misc. .., 20 N. Y. S. (2d) 135 (1940). cf.: *Tilden* v. *Green*, 130 N. Y. 29, 51-52 (1891).

As respondent asserts, and the decisions hold, the fundamental purpose of the statute is to prevent the evasion of Federal estate taxes (Res. Br., p. 31) and respondent suggests that if allowances of the character here involved made by state courts are not subjected to tax, broad avenues for tax evasion will be opened. We cannot believe that this Court would entertain the view that state courts, even apart from their lack of jurisdiction, would lend their power in aid of such devices.

**2. The New York Supreme Court did not in fact make substitutes for testamentary dispositions in this case.**

Even if the New York courts had any more power to make substitutes for testamentary dispositions than they have to make actual testamentary dispositions, the orders here under consideration did not in fact constitute such substitutes. No transfer is a testamentary disposition or even a substitute therefor unless the requisite motive be present, namely, the thought of death. In a strenuous effort to find such a motive in this case on the part of the New

York Supreme Court, the courts below and the respondent seized upon certain recitals in the allowance orders and remarks of counsel to the effect that the incompetent had no will and that the recipients of the large allowances were her prospective next of kin and who would probably inherit her property at death.

The fact that the incompetent had no will was important to a determination of whether the recipients of the large allowances were in actuality the principal objects of her bounty, for if she had had a will which left the principal part of her estate to others, considerable doubt would have been cast upon her desire to make large allowances to her daughter and grandchildren.

The first statement of counsel to the effect that the granting of the allowances would affect only the persons who applied for them and that they would eventually get the property upon the incompetent's death, appears in the Record at p. 159. This statement, made by Mr. Montgomery, of counsel for the petitioner, showing who were the natural or expressed objects of the incompetent's solicitude and bounty, was a most necessary element in any determination as to what the incompetent would, in all probability, have done had she been sane. If counsel had been actuated by any motive of inducing the state court to make a testamentary disposition of the incompetent's property (which it was powerless to do) or of evading future Federal estate taxes, it is inconceivable that he would have been so guileless as to have made them.

The second of the remarks of counsel, relied upon by the Circuit Court of Appeals, and by the respondent (Res. Br., p. 27) appears at p. 261 of the Record and reads:

> "* * * It is to me, not a matter of obtaining an allowance. It seems to be the idea of distributing part of this incompetent's property in anticipation more or less of her death."

This remark was made by Mr. Angulo, of counsel for the Committee of the incompetent, in the course of a colloquy between himself, Mr. King, of counsel for the Harris grandchildren, and Mr. Montgomery, of counsel for the petitioner, Mrs. Plumb (R. 261-266). This colloquy among counsel related solely to the question then under consideration of whether the New York Supreme Court had authority to distribute equally, between Mrs. Plumb and the Harris grandchildren, the lump sum of $250,000, which represented a portion of the surplus income accumulated since the granting of the allowances in the 1926 proceeding. Mr. Angulo took the position that the lump sum payment then proposed was not a matter of obtaining an allowance but of distributing part of the incompetent's property. After this colloquy of counsel, the petition in the 1932 allowance proceeding was amended so as to pray for an additional allowance of $25,000, to each branch of the family out of the incompetent's surplus income, such additional allowance to be made retroactive for the past five years (R. 267-268). This was within the power of the New York Supreme Court. *Matter of Heeney*, 2 Barb. Ch. 326 (1847).

While Mr. Angulo, as counsel for the Committee, made general objection to the retroactive feature of the increase, he stated he had none with respect to the prospective feature (R. 268-269). It is important to note, first, that this discussion among counsel had no bearing on the prospective allowances; and, second, that both the Court and counsel were well aware of the lack of power of the court to grant any payments which were substitutes for testamentary dispositions. The point as to whether the retroactive allowances were of the character of distributions of the incompetent's property in anticipation of her death, was thus squarely before the court in the 1932 proceeding and was rejected by that court.

But in the last analysis, even if counsel for the petitioner had the purpose of procuring from the New York Supreme Court an order making transfers in contemplation

of death, and even if counsel for the Committee was of the personal opinion that a lump sum payment or a retroactive increase was a distribution in anticipation of death and therefore beyond the power of the court to make, such purpose and opinion cannot be imputed to the Court, nor can its motive in making the orders be determined on the basis thereof.

Moreover, any comfort which the respondent may derive from these remarks of counsel vanishes before the legal presumption that the New York Supreme Court acted within its jurisdiction which did not embrace the power to make a testamentary disposition or a substitute for a testamentary disposition of an incompetent's property.

The significance with which the Government attempts to invest these recitals in the orders and the remarks of counsel disappears when we consider what the actual decision in this case was. The courts below have taxed only such portions of the large allowances as exceeded $6,000. per annum, which was the amount of the regular cash allowance given by the incompetent to each of her daughters while she was sane. These allowances up to $6,000. were declared by the courts below not to have been made by the New York Supreme Court with any testamentary purpose. Thus, it must be concluded upon the actual decisions below that if, on precisely the same record as we have here, including the recitals in the orders and the remarks of counsel, the New York Supreme Court had granted allowances of only $6,000. per annum, these transfers would not have been taxed as made with a testamentary motive or in contemplation of death. Obviously, there is no real significance in these recitals and remarks of counsel, and they do not in fact constitute any showing of testamentary purpose.

It would seem from the opinions below that the large allowances to the extent that they exceeded $6,000. were taxed by the courts below simply because they did exceed

that amount, and inferences drawn from these recitals and remarks of counsel constitute the only support for such decisions which the lower courts could find. It must be concluded, therefore, that for lack of any testamentary motive such as is required by the Federal Estate Tax Law, the allowances here under consideration were not substitutes for testamentary dispositions, any more than they were actual testamentary dispositions.

Not only was there no testamentary motive in this case, but what motive there was, was clearly associated with life. The very conception of an allowance out of annual income grows out of the contemplation of life, not death. (See also, pages 26-28 of petitioner's brief.) But in a case like this, there is less need to show a specific purpose associated with life than in a case where the transfer is made by an individual. It would appear from the cases that the finding of a specific life motive is merely a ready means for disposing of the possibility of an intent on the part of the donor to evade estate taxes. (See page 13 of petitioner's brief.) However, since it could never be supposed that a state court acting within its jurisdiction would attempt to evade estate taxes, there is no necessity of disposing of such a possibility. While an individual might very well intend to evade estate taxes and attempt to do so in a manner in which he hoped he might succeed, this never could be said of a court acting within its legal powers.

### 3. The construction of the statute.

The respondent asserts (Res. Br., pp. 37-38) that the proper construction of the statute (Revenue Act of 1926, Section 302 (c)), as applied to this case, is to be found in the majority opinion of the Court below, which said:

> "* * * We are satisfied that the proper construction of the section is as though it read: 'any interest * * * of which at any time a transfer has been made from the decedent in contemplation of death.' We have

> no doubt that if Congress had been faced with a situation like that before us, it would have included payments made by the court out of the property of an incompetent; to hold otherwise would be to frustrate the plain purpose of the section. * * *" (R. 438).

In footnote 12 at p. 38 of respondent's brief is a statement that it does not appear that the dissenting judge in the court below disagreed with the view of the majority on this point.

Yet Judge Swan, in his dissent, said:

> "* * * Whether Congress would wish to impose an estate tax on gifts made out of an incompetent's surplus income by court order for the support and education of his family seems to me the merest surmise. At any rate, it has not said so in language justifying the courts in so holding. * * *" (R. 444).

And again, Judge Swan states:

> "* * * I am unable to find in the words of section 302 (c) adequate language to subject them [the allowances] to the estate tax. * * *" (R. 443).

Clearly, Judge Swan did not believe, as did the majority court, that the allowances fell within the reach of the Estate Tax Law.

**4. As to the presumption of correctness of the determination of the Commissioner.**

Respondent argues (Res. Br., pp. 33-35) that petitioner has failed to upset the presumption of correctness of the determination of the Commissioner of Internal Revenue that the transfers were made in contemplation of death.

We recognize that the ruling of the Commissioner of Internal Revenue has the support of a presumption of correctness. That presumption, however, is by no means conclusive and if the taxpayer submits evidence to sustain

the burden of proof, that proof cannot be overcome by mere inference, but must be met and overcome by direct evidence.

> *Wickwire* v. *Reinecke*, 275 U. S. 101, 105 (1927);
> *United States* v. *Rindskopf*, 105 U. S. 418, 420 (1881);
> *Wilson* v. *Eisner*, 282 Fed. 38, 42 (C. C. A. 2nd, 1922).

The presumption that the Commissioner's determination is *prima facie* correct means no more than that, in the absence of evidence to the contrary, his action will be upheld, but when such evidence has been adduced the issue depends wholly upon the evidence and the Commissioner's determination is no longer entitled to probative force.

> *First Trust and Deposit Co.* v. *Shaughnessy*, 134 F. (2d) 940, 941 (C. C. A. 2d, 1943), cert. denied, 320 U. S. 744 (1943);
> *Hemphill Schools, Inc.* v. *Commissioner*, 137 F. (2d) 961 (C. C. A. 9th, 1943);
> *Wigel* v. *Becker*, 84 F. (2d) 706, 707-708 (C. C. A. 8th, 1936);
> *Helvering* v. *Talbott's Estate, et al.*, 116 F. (2d) 160, 162 (C. C. A. 4th, 1940).

From the evidence it conclusively appears that the allowances were made for purposes associated with life and not death. The allowances were in expectation of the continued life of Mrs. Vail and not in anticipation of her death. Upon her death her daughter and grandchildren were to receive not from her, but from the estate of Charles F. Houghton, what was theretofore Mrs. Vail's income and the allowances to the collaterals would come to an end. (R. 132) We submit the evidence which the taxpayer has adduced in this case is amply sufficient to meet any burden of proof resting upon the petitioner.

In addition, the proof offered by the petitioner is buttressed by the presumption that the New York Supreme Court acted within its jurisdiction and in making these allowances did not intend the evasion of Federal inheritance taxes.

**5. The question of need.**

Respondent reiterates that there was no showing of need for the allowances in the daughter and grandchildren of the incompetent (Res. Br., pp. 26, 27).

In our main brief at p. 40, we pointed out that the Record contains uncontradicted evidence of the financial need of the brother and sisters (R. 112-131). And we asserted that in cases where allowances payable to collateral relatives of an incompetent are proposed, a court quite naturally explores the question of need, because the court may well find no other reason which would have induced the incompetent to make such allowance.

However, in the case of gifts or allowances to children of the incompetent, need is of little or no consequence because it is entirely outweighed by other factors such as parental affection, which the court believes would have influenced the incompetent.

In the leading case of *Ex parte Whitbread*, 2 Mer. 99; 35 Eng. Rep. 878 (1816), it was made clear that in dealing with allowances to the wife and children of an incompetent such allowances should be proportioned to the incompetent's circumstances and not based on the need of the children and their right to support.

It is clear that under the Federal Estate Tax Law gifts not in contemplation of death may be, and frequently are, made which are greatly in excess of the financial needs of the donees. In *United States* v. *Wells*, 283 U. S. 102 (1931), the gifts were held not to have been made in contemplation of death although they were obviously greatly in excess of any possible financial need of the donees. For other ex-

amples of *inter vivos* gifts in amounts far in excess of any possible need on the part of the donees which were held not to have been made in contemplation of death, see:

| *Case* | *Amount of Gift* |
|---|---|
| *Commissioner* v. *Nevin*, 47 F. (2d) 478 (C. C. A. 3rd, 1931), cert. denied, 283 U. S. 835 (1931) | $36,790,376.17 |
| *Rea* v. *Heiner*, 6 F. (2d) 389 (W. D. Pa., 1925) | 10,306,089.49 |
| *Estate of Moir* v. *Commissioner*, 47 B. T. A. 765 (1942) | 2,924,541.37 |
| *Isaac Gimbel, et al., Executors* v. *Commissioner*, 11 B. T. A. 214 (1928) | 1,406,000.00 |
| *Willcuts* v. *Stoltze*, 73 F. (2d) 868 (C. C. A. 8th, 1934) | 1,335,371.42 |
| *American Security & Trust Co., et al.* v. *Commissioner*, 24 B. T. A. 334 (1931) (Acquiesced in by Commissioner of Internal Revenue XI-1 C. B. 1) | 1,250,195.86 |
| *Lippincott, et al.* v. *Commissioner*, 72 F. (2d) 788 (C. C. A. 3rd, 1934) | 1,066,868.01 |
| *Colorado National Bank, et al.* v. *Commissioner*, 305 U. S. 23 (1938) | 800,000.00 |

An examination of Articles 15 and 16 of the applicable Treasury Department's Regulations 80, dealing with transfers in contemplation of death, discloses that the Regulations do not even mention "need" of the donee as a test for determining whether transfers have been made in contemplation of death.

## Conclusion

It is plain that respondent in seeking to tax these allowances did so, and that he was upheld by the courts below, merely because the New York Supreme Court granted the allowances in amounts substantially larger than the regular annual cash allowances the incompetent had given while sane.

Recognizing that this fact alone would not support the tax, the courts below and the respondent have evolved a number of different, and in some cases mutually exclusive, theories. The District Court imposed the tax on a theory which was rejected by the Circuit Court of Appeals which adopted a different theory. Respondent, now apparently discontent with both, urges that this Court adopt a third theory which, incidentally, respondent did not argue in either of the courts below.

The true explanation for respondent's action and the decisions of the courts below, seems to be that they felt the New York court had abused its discretion in making such an increase and that, for one reason or another, this should subject such increase to tax. The proof of this is that only the increases have been held taxable. There is also further proof at page 22 of his brief in this court, where respondent says:

> "* * * But the records in the allowance proceedings will be searched in vain for any justification for the increases other than that, assuming the decedent to be competent, she would be motivated in making the transfer by a purpose to substitute them for the distribution of her property which would occur at her death and as a result thereof." * * *"

On this point, the decision of the District Court was as follows:

> "If I had the authority to change the allowances as made by the orders of the state court to the direct

> heirs by reducing them below $75,000 but exceeding $6,000 in some amount, I would be disposed to do so. I do not believe that I have the authority to do so." (R. 398).

The following is from the opinion of Judge Hand:

> "* * * for the judges had no evidence whatever from her past conduct for supposing that, if she looked forward to ending her life in full possession of her faculties, she would have given away every year to her daughter, her grandchildren and her brother and sisters, more than $160,000 out of the $250,000 which remained to her after paying her taxes and expenses. The allowances she had theretofore made did not remotely approach such figures." (R. 438).

As pointed out in petitioner's brief, there is nothing in the principles of New York law or equity as applied by the New York courts, limiting them to granting allowances in only the amount which the incompetent had given while sane. As Lord Eldon said in *Ex Parte Whitbread*, 2 Mer. 99; 35 Eng. Rep. 878 (1816),

> "* * * So also, where the father of a family becomes a lunatic, the Court * * * makes an allowance for them proportioned to his circumstances. * * *"

The amount is in the discretion of the equity court and is certainly not subject to review collaterally by the Federal courts in an action involving the Estate Tax on an incompetent's estate.

The respondent and the courts below overlooked (1) the substantial gifts made to her daughters by the incompetent from time to time while sane in addition to the regular annual cash income of $6,000, to each (See petitioner's brief, p. 29 and respondent's brief, p. 4); (2) the tremendous increase in the incompetent's income during the last year or so before her commitment, and particularly the great increase which took place in 1926, the year of the

first allowance application (R. 147); and (3) her greatly curtailed ability to use her income herself (See pp. 38 and 39 of our main brief).

But even if the New York Supreme Court abused its discretion (which we do not concede) in granting allowances substantially greater than the annual cash allowances the incompetent had given while sane, that does not make the allowances so transferred *ipso facto* in contemplation of death. The boundaries of the New York Supreme Court's jurisdiction and of the scope of the Federal Estate Tax Law are not co-extensive, and by the mere act of exceeding its jurisdiction, a state court does not automatically bring the transfers made by its orders within the scope of transfers in contemplation of death. A motive or intent to exceed its powers is not the testamentary motive or intent required by the Federal statute.

The case boils down to this: The New York Supreme Court is empowered to grant such allowances out of the surplus income of an incompetent's estate as it finds, on the record before it, that the incompetent would probably have granted himself if sane. The situation, then, is no different from that of a wealthy individual who, let us say, becomes blind and although contemplating a long life is no longer disposed to maintain expensive residences and a luxurious standard of living which he has theretofore shared with his children. As a result, his surplus income accumulates. If, under these circumstances, he determines to allow a portion of his surplus annual income to his childr n so as to give them greater advantages in living or permit them to procure the facilities he can no longer furnish for them, can it be said that although a grant of 5% of such surplus income springs from a life motive, any amounts above such percentage are to be deemed to be transfers in contemplation of death? How can the required motive be measured or determined by the number of dollars involved? Or by generosity as opposed to parsimony? Yet that is precisely

what the courts below have held and respondent now urges. We submit that their positions are insupportable.

If the decisions below should be affirmed, it is feared that the result would be to restrict state courts in the proper exercise of their equity jurisdiction in granting allowances. No state court could thereafter entertain applications for allowances without the fear that it might be doing something which would subject the incompetent's property passing at death to an estate tax on account of the allowances. Certainly no state court would feel free to grant any allowances in excess of the cash allowances which it found the incompetent had given while sane, and in cases where there was no proof of any prior allowance given by the incompetent, the state courts would not feel free to grant any allowance. As has been shown at p. 29 of petitioner's brief, under the New York law, that of other states and the common law, courts are not restricted to what the incompetent herself had given while sane. They may even grant allowances to persons to whom the incompetent gave nothing while sane.

See for example:

*Matter of Flagler*, 248 N. Y. 415 (1928);
*Sheneman* v. *Manring, et al.*, 152 Kan. 780 (1940);
*Matter of Carysfort*, 1 Cr. & Ph. Rep. 76 (1840).

But the result of the decisions below, if affirmed, would be to deny such power. Thus there would be a restriction imposed by way of indirect sanction by the Federal Government and Federal courts, upon the equity powers of the state courts, resulting in discrimination under the Federal Estate Tax Law to the prejudice of the estates of incompetent persons which should not be permitted under the Fifth Amendment of the Constitution of the United States.

* * * * * *

It is respectfully submitted that the allowances are not includible in the decedent's taxable estate as transfers made in contemplation of death. The judgment of the District

Court, which was affirmed by that of the Circuit Court of Appeals, should be modified and judgment directed to be entered for the petitioner in the sum of $466,912.27, the amount demanded in the complaint, with interest on said sum of $466,912.27 from June 22, 1938.

Respectfully submitted,

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